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UNCLAS SECTION 01 OF 02 TAIPEI 004873

SIPDIS

STATE PLEASE PASS AIT/W AND USTR

STATE FOR EAP/RSP/TC, EAP/EP

USTR FOR WINTER AND WINELAND

USDOC FOR 4420/USFCS/OCEA/EAP/LDROKER
USDOC FOR 3132/USFCS/OIO/EAP/ADAVENPORT
TREASURY FOR OASIA/LMOGHTADER
TREASURY PLEASE PASS TO OCC/AMCMAHON
TREASURY ALSO PASS TO FEDERAL RESERVE/BOARD OF
GOVERNORS, AND SAN FRANCISCO FRB/TERESA CURRAN

E.O. 12958: N/A

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SUBJECT: Taiwan Legislature meddles with interest rates

SUMMARY

1. On December 6 Taiwan's Legislative Yuan (LY) reached agreement to set a 10% cap on credit and cash card spreads, and increase monthly minimum payments to 20% of the balance from the current 3%. According to the agreement, the proposed cap was to have a "second" reading December 9 (without ever having had a first reading). In response to the agreement, average stock prices of banking issues dropped sharply on December 8 as banks complained the measure would force them to stop issuing cards and ratings firms indicated it could lead to a downgrading of Taiwan's financial ratings. In a rare triumph of reason over politics, the bill has been shelved for now. End summary.

Efforts to Halt Legislation

2. Opposition KMT and PFP legislators began promoting the interest cap legislation prior to the December 3 local elections as a way to reduce interest burdens on credit and cash cardholders. Rising consumer debt has become a topic of media interest. The December 6 agreement to schedule the bill for a "second" reading (of three required readings) took the financial community by surprise. In the days before the scheduled "second" reading on December 9, bankers and foreign investors voiced loud opposition to the bill. As a result, ruling DPP Policy Committee Chairman Ke Chien-min asked LY President Wang Jing-pyng to postpone further consideration of the bill. Banking Bureau Chief Secretary Nancy Yang told AIT that the Financial Supervisory Commission was also lobbying to stop the legislation.

Immediate Impact

3. The draft legislation would require banks to reduce credit and cash card interest rates from the current 20% to 12% (which banks claim is insufficient to cover card issuance costs.) Passage of the bill would erode profitability of credit and cash card issuing banks. The December 6 agreement drove the stock price index of the banking sector down 4.4% from 917.66 points on December 6 and to 876.91 points on December 8. The capitalization of listed banks and financial holding companies shrank NT\$117.57 billion (US\$3.5 billion) to NT\$2,518.9 billion (US\$75.2 billion). Three large financial holdings corporations (China Trust, Taishin, and Cathay) experienced plunges of 10-12% in stock prices.

Even Worse Long-Term Consequences

4. According a CLSA assessment (CLSA is the Asian investment banking arm of CREDIT AGRICOLE, the world's fifth largest bank), passage of the bill could prompt banks to stop all new card lending since the spreads would not cover the risk. As old balances were paid off, customers would not get new credit, causing a contraction of cash and credit card lending. Without other non-card lending products to fill the gap, a significant contraction of overall consumer credit would result. This would have a negative effect on consumer spending and Taiwan's domestic economy. The bill would also increase the monthly minimum payment to 20% of the balance from the current 3%, which would force many credit and cash cardholders to default on payments. Taishin Bank President Tsai Men-feng warned that passage of the bill would force people to go to underground banks which charge interest rates of over 40%, and which are associated with criminal elements.

PAAL